



**WASHINGTON STATE INVESTMENT BOARD
BOARD ADOPTED POLICIES**

POLICY NUMBER: 2.20.100

EFFECTIVE DATE: 5/20/04

TITLE: Labor and Industries'
Insurance Funds

SUPERSEDES: 11/21/02

BOARD ADOPTION: 5/20/04

APPROVED: *Joseph A. Dear*

PURPOSE:

This document outlines the investment policy and guidelines for the Department of Labor and Industries' (L&I) Insurance Funds managed by the Washington State Investment Board (WSIB), and supersedes any prior Board-adopted policies.

POLICY:

Standard of Care

Under RCW 43.33A.030, trusteeship of the L&I Insurance Funds is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives listed below.

Strategic Objectives

In accordance with RCW 43.33A.110, the portfolio is to be managed to limit fluctuations in the industrial insurance premiums, and, subject to this purpose, achieve a maximum return at a prudent level of risk. Based on this requirement, the order of the objectives shall be:

1. Maintain the solvency of the funds.
2. Maintain premium rate stability.
3. Ensure sufficient assets are available to fund the expected liability payments.
4. Subject to those above, achieve a maximum return at a prudent level of risk.

Performance Objectives

The performance objectives are intended to provide the WSIB and L&I with a way to measure the success of this investment policy, the overall asset allocation strategy, and the implementation of that strategy over time. First and foremost the performance of the investment portfolios shall be judged relative to the Strategic Objectives. With the first three criteria met, the actual rates of return of the portfolios will be compared to the Comparable Market Index (CMI) for each fund. The CMI's are developed and calculated by the consultant with the goal to construct a hypothetical passive portfolio with the duration, asset allocation, and appropriate mix of fixed income sectors based on the individual targets for each L&I fund. The return for each fund's portfolio should not be significantly different from that of its CMI over the long term.

Portfolio Constraints

- A. All assets under management by the WSIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of statutes RCW 43.33A.110 and RCW 43.33A.140, which state in part that the WSIB is to "...establish investment policies and procedures designed to attempt to limit fluctuations in industrial insurance premiums, and, subject to this purpose, to maximize return at a prudent level of risk."
- B. No corporate fixed income issue's cost shall exceed three percent of the fund's market value at the time of purchase, nor shall its market value exceed six percent of the fund's market value at any time (RCW 43.33A.140).

Asset Allocation

	Fixed Income Target	Equity Target	Equity Range
Accident Fund	90%	10%	8%-12%
Pension Reserve Fund	90%	10%	8%-12%
Medical Aid Fund	70%	30%	24%-36%
Supplemental Pension Fund	100%	0%	-

Asset allocation will be reviewed every three to four years or sooner if there are significant changes in funding levels or the liability durations.

Market conditions, funding status, and liability assumptions are dynamic, not static; therefore, WSIB staff will meet quarterly with L&I staff to review the investment portfolio, the status of the funding levels, the liability durations, and to evaluate the percentage of the supplemental pension fund that is to be considered non-cash.

Assets will be rebalanced across asset classes when market values of the assets fall outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

Asset Class Structure

Asset class structure is established by the Board with guidelines for staff to move assets in order to achieve the funds' overall objectives.

Equity

The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the Wilshire 5000. The benchmark and structure for international equities will be the Morgan Stanley Capital Indexes Europe, Australia, Far East (MSCI EAFE) index. Both portfolios will be 100 percent passively managed in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.

Equity Allocation:

	Target	Range
U.S. Equity	85%	80%-90%
International Equity	15%	10%-20%

Fixed Income

The fixed income portfolios' structure will vary widely among funds depending upon the required duration target.

Accident Fund (608): within plus or minus 20 percent of a duration target of nine.

Pension Reserve Fund (610): within plus or minus 20 percent of a duration target of nine.

Medical Aid Fund (609): within plus or minus 20 percent of a duration target of six.

Supplemental Pension Fund (881): the non-cash portion of the portfolio will have a duration that is between 1.75 and 2.25.

The duration targets will be reviewed every three years, or sooner, if there are significant changes in the funding levels or the liability durations.

It is the goal of the fixed income portfolios to match the target durations. Although there may be differences from the targets due to market conditions, over any extended period of time those differences should not be material.

Permissible Fixed Income Investments

1. *U.S. Treasuries and Government Agencies.*
2. *Credit Bonds.*
3. *Mortgage-Backed Securities* rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's Investor's Service (Moody's).
4. *Asset-Backed Securities* rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's.
5. *Commercial Mortgage-Backed Securities* rated BBB- or higher by Standard & Poor's and Baa3 or higher by Moody's.
6. *Investment Grade Non-U.S. Dollar Bonds.*

Sector Allocations

Sector allocations are to be managed within the ranges presented below. These targets are long-term in nature. Deviations may occur in the short-term as a result of interim market conditions. However, if a range is exceeded the portfolios must be rebalanced as soon as it is practical to the target allocations.

Target Allocations for Fixed Income Sectors:

U.S. Treasuries and Government Agencies	5 – 25%
Credit Bonds	20 – 70%
Asset-Backed Securities	0 – 10%
Commercial Mortgage-Backed Securities	0 – 10%
Mortgage-Backed Securities	0 – 25%
Total Bonds	100%

Total holdings of below investment grade credit bonds (rated BB+ or below by Standard & Poor's or rated Ba1 or below by Moody's) should not exceed five percent of total fixed income holdings.

Reporting

- A. A management information system is to be used for reporting internally to senior staff on the implementation of this policy. This report is prepared monthly to include, but is not limited to:
1. Current market values and allocations, by sector, compared to the policy ranges;
 2. Aggregate and individual portfolio characteristics compared to guidelines; and
 3. Delinquencies and defaults.
- B. An executive management report is to be provided to the Board quarterly showing market values and performance.

RESPONSIBILITIES:

Washington State Investment Board - Responsible for approving the fund's strategic investment policy.

Public Markets Committee - Responsible for reviewing the structure, strategy, and performance of the funds.

Staff - Responsible for recommending an investment policy to the Board, for implementing the policy, and for reporting to the Public Markets Committee and the Board.

Original Policy Adopted 10/20/92

Revised 6/16/94

Revised 9/21/95

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